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C O N F I D E N T I A L ASUNCION 000258

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NAIROBI FOR MICHAEL FITZPATRICK  
TREASURY FOR CKUSHLIS  
STATE FOR WHA/EPSC, EB/IFD/OMA  
STATE PASS TO USTR FOR MSULLIVAN  
USAID FOR AA/LAC ADOLFO FRANCO  
SOUTHCOM FOR POLAD BARBARA MOORE  
NSC FOR SUE CRONIN

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TAGS: [ECON](#) [PREL](#) [EFIN](#) [PINR](#) [PA](#)  
SUBJECT: PARAGUAY: CENTRAL BANK PRESIDENT TESTING PRESIDENT  
DUARTE'S SUPPORT

REF: A. A) ASUNCION 201  
[1](#)B. B) ASUNCION 35  
[1](#)C. C) 05 ASUNCION 1486

Classified By: ECON Patrick R. O'Reilly for reasons 1.4(b),(d).

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SUMMARY  
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[1](#)1. (C) In the Ambassador's introductory call on March 3, Central Bank (BCP) President Monica Perez said that little had changed with respect to the dispute between Perez and the four other BCP Board members (reftels). She said she had accomplished all she could in the current hostile environment, and has told President Duarte that she will resign if something isn't done to remove the worst of the four Central Bank Board members by March 20. Perez asserted that she still believes in Duarte's good intentions, and commented that Duarte told her that he only trusts two members of his cabinet: Perez and Finance Minister Bergen. The others are his "friends" but he knows they "all have their things." The Ambassador raised the anti-money laundering law and noted both its importance to Paraguay's anti-corruption efforts, and our view that passage of the law is a litmus test of the GOP's political will. Perez supports the law and promised to raise it with the economic team. Perez was pleased to learn from IMF staff that her attempts to cleanse the BCP's balance sheet and improve internal controls had helped reduce the 2005 quasi-fiscal deficit to 0.2 percent of GDP, much lower than the 0.6-0.8 percent range in 2004 and 2003. She warned that inefficient and expensive monetary policy in Paraguay as well as the fact that the BCP is undercapitalized could cause serious problems in the future. President Duarte's reaction to Perez's private ultimatum will be a window into his willingness and ability to take on vested interests for the sake of reform and modernization. End Summary.

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CENTRAL BANK TENSIONS UNABATED  
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12. (C) On March 3, Ambassador Cason, accompanied by Econcouns, had his introductory call on Central Bank (BCP) President Monica Perez. Perez said that little had changed with respect to the dispute between Perez and the four other BCP Board members (reftels). The working environment remains hostile, and she said she meets resistance at every turn, leading her to never sign documents without thorough vetting by her few trusted advisors, no matter the claimed urgency. The environment is exhausting, and leads to long nights and weekends of work for her and her inner circle. She admitted that she would not continue forever, and had badly underestimated the mess she would encounter when she accepted the job.

13. (C) Perez told the Ambassador that she had told President Duarte that she had accomplished all that she could with the current hostile Board, and that continued progress reforming the bank, and her continued tenure as the President, were contingent on the removal of two of the Board members, specifically Diego Martinez and Raul Ayala. A third Board member, Fernando Silva, is problematic, but is from the Liberal Party and too protected politically to be removed. In any case, Perez characterized Silva as "not too bright" and therefore less difficult to deal with than the other two. The fourth member is less political and she believed him not to be malicious.

14. (C) Tactics used to frustrate Perez include frequent attacks in the press by the other Board members, the floating of rumors of Perez alliances with political enemies of President Duarte, and the leaking of rumors of her resignation, leading to persistent calls from the press seeking comment. For her part, Perez said that she generally avoids the press given her impatient, direct nature, fearing

that she would be drawn into telling it like it is, which would not be good for the institution or for President Duarte.

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A MARCH 20 ULTIMATUM  
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15. (C) According to Perez, President Duarte assured her that he would act to remove Martinez and/or Ayala, but asked for her patience beyond the establishment of the new leadership of the Colorado Party (ANR), expected to occur on March 8 and 19. A key issue at stake will be the position of powerful Colorado Senator Galaverna. Perez said that Minister of Public Works Jose Alderete will become the President of the Colorado Party (ref A) and that Galaverna will be sidelined. Perez asserted that Galaverna is unhappy since he senses the effort to reduce his influence. She also mentioned as an aside that one of Galaverna's girlfriends is a dentist in the Central Bank's medical unit, although Perez said she hasn't met her.

16. (C) While Perez reiterated that she continues to believe in Duarte's good intentions, she told the Ambassador that if the President doesn't act to remove the two directors by about March 20, she will resign. Note: In the past (refs B and C), Perez had told us that she would only go if impeached. By her own admission, the stress was beginning to affect her health, and she has evidently decided only to stay if she can continue her efforts to reform the bank. End note. Interestingly, Perez commented that President Duarte told her that he only trusts two members of his cabinet: Perez and Finance Minister Bergen. The others are his "friends" but he knows they "all have their things."

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MONEY LAUNDERING LAW AND IMF PROGRAM  
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17. (C) The Ambassador raised the anti-money laundering law and noted both its importance to Paraguay's anti-corruption efforts, and our view that passage of the law is a litmus

test of the GOP's political will. Perez supports the law and promised to raise it in a meeting with the visiting IMF team and the GOP Economic Team later that afternoon. She suggested that the possibility existed that a reference to the law could be included in the IMF program documents, even if not as a performance criterion or benchmark. She told us that the interagency group on money laundering only met three or four times in 2005, and that the BCP has been trying to call another meeting.

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MAKING HEADWAY CLEANING UP THE BANK  
-- BUT STILL UNDERCAPITALIZED  
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18. (C) Perez was proud of the fact that, despite the constant resistance of the Board members and others within the BCP, her efforts to clean up the Bank's balance sheet had achieved positive results. The IMF staff team informed Perez that in 2005 the quasi-fiscal deficit of the BCP was 0.2 percent of GDP, much lower than the 0.6-0.8 percent range in 2004 and 2003. She said that the controls she has implemented are working. More needs to be done, though. Perez lamented that conducting monetary policy in Paraguay is both inefficient and very expensive. With the lack of a domestic government bond market, the BCP issues its own instruments on which it pays interest. Combined with the fact that the bank is significantly undercapitalized after the series of bank failures of the late 1990s, the bank has been running quasi-fiscal deficits for a number of years. Perez warned that if improvements are not made, and the bank not recapitalized, the situation would eventually "explode."

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COMMENT  
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19. (C) Perez's ultimatum, if firm, represents another litmus test for President Duarte. With the ANR elections over and spectacularly successful for Duarte, and with the naming of the ANR leadership this week, there will be fewer obvious excuses for inaction. With Monica Perez a clear reformer who is having a direct impact on certain vested interests, if the President acts to renew the Board and keep Perez, it will be a strong signal of his commitment to reform and modernization. If she goes, it may be difficult for the President to find a comparably able and committed replacement.

CASON

CASON